

# Accounting Policy Update: Thoughts on the Honeywell pension changes

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## Move towards international accounting

Honeywell's pension accounting change to more of a mark to market framework moves the company closer to the way that international accounting standards account for pensions. This is similar to the type of accounting that the United States is likely to have in a few years if we were to adopt International Financial Reporting Standards or if the FASB were to change US GAAP pension accounting to be more in line with international rules. As a point of reference, AK Steel currently uses a similar methodology and investors can see how historically this has, at times, resulted in large, lumpy 4Q charges, or no charges at all. While the change means that Honeywell's accounting may be dramatically different than at its peers, the reality is that many reported pension expense figures are already not comparable given varying smoothing policies that are allowable under US GAAP.

## No change to economics or cash flow

While the company's announcement significantly changes the way the plan is accounted for through the income statement, it does not change the size of its pension liability or any funding requirements. Remember that pension accounting and pension funding rules are completely separate – GAAP accounting does not mandate the amount and timing of contribution requirements. The ERISA regulations and the Pension Protection Act determine if and when plan sponsors need to contribute assets into a plan. This change has no impact on those regulations.

## Asset mix shift continues the ongoing trend

While much of the focus on Honeywell's announcement on November 16 related to the accounting implications of its change, just as significant was its indication that it is shifting asset allocation to a more fixed income focus. This continues the trend that we have seen in the corporate pension space for several years, driven in no small part by the stricter funding and accounting rules that have been enacted over the past five years. Note that many of these plans are not increasing allocations to fixed income because they necessarily find it an attractive asset class, but rather because fixed income securities are a better match for their pension liabilities. We expect this trend to continue, especially as additional future accounting rule changes are finalized and as companies increase funded status through contribution activity.

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